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TAGS: [ECON](#) [EFIN](#) [EPET](#) [RS](#) [MD](#)
SUBJECT: ECONOMY MINISTER DESCRIBES PROGRESS AND
NEED FOR EU SUPPORT

Classified By: Charge d'Affaires Kelly
Keiderling for reasons 1.4 (b) and (d)

¶1. (C) Summary: During Ambassador Chaudhry's October 6 courtesy call on Deputy Prime Minister and Minister of Economy Igor Dodon, the Minister explained that the GOM had privatized over 90 percent of land and 80 percent of enterprises following independence. Since then Moldova had succeeded in attracting European investors and was the only country in the region that enjoyed both free trade with CIS countries and preferential trade status with the EU. The Minister stressed the GOM's strong desire for a new mandate from the EU supporting integration. He outlined plans to develop infrastructure and to restructure the energy sector. Dodon noted that Moldova could not do much about its natural gas dependence on Russia, but hoped to encourage private investment to develop sources of energy. He argued that pension reform was necessary but could not be implemented before elections. He hoped reforms would reduce the agricultural sector from 35 percent to 15 percent of the economy and help the services sector to grow. End Summary.

Economic Development and Privatization in the 1990s

¶2. (C) Minister Dodon outlined Moldova's economic development since independence and explained that Moldova had inherited a state-managed economy that had required major restructuring. The economy had been primarily agricultural with a well-developed manufacturing sector that had been tightly connected to the military-industrial complex of the Soviet Union. Most factories had produced parts for Soviet military equipment. During the 1990s the GOM had succeeded in introducing numerous reforms that had transferred 80 percent of public assets into private hands. At the same time, the GOM had privatized 90 percent of the land in the country.

Economic Reform after Privatization

¶3. (C) The Minister explained that after the privatization of state assets, a boom in consumption had begun in Moldova around 2000. At that time the GOM had understood that it needed to increase domestic production to meet consumption demand and had set a goal of attracting foreign investment. The GOM had realized that it had to attract foreign investors to its small consumer market. One

advantage Moldova had to offer investors now was that it was the only country in the region that enjoyed both free trade with CIS countries and also preferential trade status with the EU. Minister Dodon pointed out that Ukraine had free trade with CIS countries but not with the EU, while Romania could trade freely in the EU but not with CIS countries. Moldova had been successful in attracting European businesses, as shown by the fact while approximately 70 percent of Moldova's trade had been with Russia in the 1990s, 52 percent of its trade was now with the EU. Further, the Minister noted that in 1997-98 Russia had been the source of 70 percent of the foreign direct investment (FDI) into Moldova but now more than 56 percent of FDI was from the EU.

¶4. (C) Minister Dodon described how the GOM had launched Guillotine Act reforms over the past three years to analyze all by-laws and parliamentary laws. He stated that the GOM had succeeded in excluding the maximum possible number of laws that had been impediments to domestic and foreign entrepreneurs. The GOM no longer permitted ministries to enact business regulations; only Parliament or the executive branch in a few cases could introduce laws on business.

Economic Liberalization

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¶5. (C) Minister Dodon explained that the GOM had introduced three recent efforts to liberalize the economy in 2007 and to promote investment. First, the government had introduced zero corporate income tax on companies in Moldova. Only distributions to shareholders can be taxed. Profits reinvested or held by a company are not taxed. Secondly, the GOM had introduced a tax amnesty on January 1, 2007 which had cancelled the debts of all businesses with the government. The amnesty had also forbidden the auditing or examination of prior business activity. Thirdly, the GOM had adopted capital legalization which had allowed Moldovan individuals to register previously undeclared capital. Minister Dodon felt that these decisions had substantially improved the atmosphere for FDI. FDI had doubled in 2007 and in 2008 FDI was already 70 percent ahead of last year's total. The Minister expected 7 percent growth in GDP and predicted inflation would remain in the single digits in 2008.

Moldova Faces Challenges

¶6. (C) Dodon said that Moldova faced major political and socio-economic challenges. He underlined that the GOM continued to pursue integration with the EU and the GOM now needed a clear signal from the EU. The Minister stressed that a new mandate from the EU was very important because of the geo-political concerns that had arisen in the region as a result of the conflict between Russia and Georgia. The efforts to resolve the conflict with Transnistria had become even more important and the GOM was thankful for the support of the USG in seeking a solution in the 5-plus-2 format.

¶7. (C) Dodon added that the GOM would have to reform its pension system. He was currently

working with the World Bank to prepare the legal framework for this reform. The implementation would have to be undertaken by the next government, because no administration could introduce painful reforms before an election.

18. (C) The Minister believed that Moldova also needed investment in infrastructure to attract FDI. The two major areas that needed attention were the airport and roads. He noted that another important step would be the privatization of two state monopolies, Air Moldova and Moldtelecom. Minister Dodon felt that the government should privatize state enterprises only when the private sector was ready to invest. In other cases, the government should pursue public-private partnerships. Future GOM budgets would need to devote more funds to infrastructure improvement projects. The GOM needed an MCC Compact agreement to improve roads and wanted to sign a Compact as soon as possible. He stated that further delay would be interpreted domestically as an effort to avoid reaching an agreement with the current government.

19. (C) The Minister stated that the energy sector was another serious concern. There was not much Moldova could do about its natural gas dependency on Russia; however, the GOM did control its sources for electricity and heating. The GOM planned to encourage private investment to help diversify sources of energy. The government hoped to pursue public-private partnerships in the energy sector next year.

The Future Economy in Moldova

110. (C) The Minister said that since agriculture was the largest sector of the Moldovan economy, at 30-35 percent, many felt that the government should focus on this sector and develop food processing. Minister Dodon thought that the agricultural sector should be only 10-15 percent of the economy. He suggested that the economy should focus on services such as finance, IT, and transportation logistics.

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USG Support for Reform and European Integration

111. (C) Ambassador Chaudhry expressed USG support for Moldova's reforms. He noted that the introduction of laws and regulations to liberalize the economy and attract investment had proceeded well and encouraged the government to focus on implementation to attract more investors to Moldova. The Ambassador pointed out two recent foreign investment conflicts, Sun Communications and PRO TV, that were of concern because they could potentially harm the perception of the investment climate in Moldova and both concerned freedom of the media. The Ambassador noted that corruption was also a serious problem that discouraged investors. The Ambassador expressed his desire to work with the Minister to encourage development and said he would like to organize an investment mission focusing on agriculture in the near future.

Comment

¶12. (C) Moldova has come a long way since independence and continues to introduce reforms and seek closer integration into Europe. While progress has been made in reforming legislation, Moldova now needs to show diligence in implementing its new laws and regulations. Salaries remain low in civil service and corruption continues to be a major problem. In the agricultural sector, most farmers have small plots and little has been done to encourage the consolidation of farm land to create larger and more efficient enterprises. The fact that FDI continues to grow is positive. Russian dominance of the energy sector will continue to be a major challenge. It remains to be seen what kind of private investment the GOM can attract to the electricity sector.

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